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ABSTRACT

The administration recently announced a broad overhaul of the welfare system called the program for better jobs and income. This proposed plan would consolidate three major components of the current welfare system and provide, for the first time, a nationwide minimum federal cash payment for all the poor. In this paper the existing welfare system is reviewed. Changes which would be brought about by the administration's plans are presented. The structure of the existing program designed the aid the poor is outlined as is a description of the many problems with the welfare system today. The administration's new proposal is also outlined. A crucial issue in all proposals designed to aid low income families is that of work incentives. The effect on work incentives of the administration's proposal is compared with the current system. A second crucial concern with reform proposals is how they affect current welfare recipients and other groups of low income families. Because of the complexity of the administration's proposal, this is a difficult question to answer definitely, but a rough answer is provided. This is accomplished by looking at the effect of the proposal on several types of families. The extent to which individual states will supplement the benefits which are provided by the federal government is the main complication in assessing who will gain and who will lose. There are incentives for such supplementation in the proposal, and these are explained. A criticism of the administration's proposal is also presented. (Author/AM)

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THE PROGRAM FOR BETTER JOBS AND INCOME—A GUIDE AND A CRITIQUE

Sheldon Danziger, Robert Haveman, and Eugene Smolensky

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Reprint 259

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95th Congress
1st Session } JOINT COMMITTEE PRINT

THE PROGRAM FOR BETTER JOBS AND INCOME—A GUIDE AND A CRITIQUE

A STUDY

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

OCTOBER 17, 1977

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LETTERS OF TRANSMITTAL

OCTOBER 12, 1977.

To the Members of the Joint Economic Committee:

Transmitted herewith for use of the members of the Joint Economic Committee and other Members of Congress is a study entitled "The Program for Better Jobs and Income—A Guide and Critique."

This is one of three studies commissioned by the Joint Economic Committee on the subject of welfare reform. These studies are intended to provide information and analysis to the Congress on the important issue of welfare. This study, prepared by Professors Sheldon Danziger, Robert Haveman, and Eugene Smolensky, focuses on the strengths and weaknesses of both the present welfare system and the Administration's welfare reform proposal.

The views expressed in this study are those of its authors and should not be interpreted as representing the views or recommendations of the Joint Economic Committee or any of its members.

Sincerely,

RICHARD BOLLING,
Chairman, Joint Economic Committee.

OCTOBER 7, 1977.

Hon. RICHARD BOLLING,
Chairman, Joint Economic Committee, U.S. Congress,
Washington, D.C.

DEAR MR. CHAIRMAN: Transmitted herewith is a study entitled "The Program for Better Jobs and Income—A Guide and a Critique", prepared by Professors Sheldon Danziger, Robert Haveman, and Eugene Smolensky, University of Wisconsin.

The study is the second of three committee studies on welfare reform intended to provide information and analysis on important aspects of the welfare reform proposal, including a review of its macroeconomic effects and an analysis effects of its labor market implications.

Drs. Danziger, Haveman, and Smolensky have reviewed some of the key economic issues which should be considered in a discussion of welfare reform.

This study was reviewed by Tom Cator and Deborah Norelli of the committee staff.

Sincerely,

JOHN R. STARK, *Executive Director.*

"The Program for Better Jobs and
Income---A Guide and A Critique"

E R R A T A

pg. 14, second line from the bottom should read: "$4,191" not "$4,291" and "$200" not "$100"

pg. 15, Table I, Total Income Proposed System should read: "4,191" not "4,291"

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THE PROGRAM FOR BETTER JOBS AND INCOME—A GUIDE AND CRITIQUE*

By SHELDON DANZIGER, ROBERT HAVEMAN, AND EUGENE SMOLENSKY**

1. INTRODUCTION

The Administration recently announced a broad overhaul of the welfare system called the program for better jobs and income. The plan would consolidate three major components of the current welfare system and provide, for the first time, a nationwide minimum Federal cash payment for all the poor. It also pledges to provide a public service job for some of those able and expected to work, as an integral part of the welfare system. Earnings, welfare, manpower policy, and taxes would be interrelated through an expanded earned income tax credit and a new, nationally uniform system of basic income support payments.

While some parts of the Administration's proposal are new, many of its characteristics are direct descendants of earlier attempts to reform welfare, most notably President Nixon's family assistance plan. The major new elements in the Administration's proposal are: Combining welfare reform with public job creation, integrating an earnings supplement with income-conditioned cash assistance, and extending cash benefits to individuals and intact families. The more standard elements common to many welfare reform proposals are the establishment of a more uniform national basic benefit structure for all low-income families, the imposition of a work requirement as a condition for receiving benefits, and the administrative consolidation of at least some of the several existing income-conditioned programs.

The purpose of this paper is first to review the existing system and then to present the changes in it which would be brought about by the Administration's plan. In Section 2, the structure of the existing melange of programs designed to aid the poor is sketched, and some of the achievements of these policies are described. Section 3 outlines the problems with the welfare system which have led to its being referred to by the President as a "mess." Following this, the Administration's proposal is outlined in Section 4. A crucial issue in all proposals designed to aid low-income families is that of work incentives. Simply

*Based on the HEW news release (HEW News), Aug. 6, 1977. The final form of the Administration's bill may differ in some details from this release.

**The authors wish to acknowledge the comments of Katherine Bradburr, Irwin Garfinkel, Robert Lampman, Robert Plotnick, and Timothy Smeeding. Sheldon Danziger is an Assistant Professor of Social Work, University of Wisconsin, Madison. Robert Haveman and Eugene Smolensky are Professors of Economics at the University of Wisconsin, Madison. All of the authors are staff members of the Institute for Research on Poverty, University of Wisconsin, Madison.

stated, does the proposal discourage work effort by providing an alternative income source, and by decreasing this income in response to increases in labor income? This issue is discussed in Section 5, where the effect on work incentives of the Administration's proposal is compared with that of the current system. A second crucial concern with reform proposals is, how they affect current welfare recipients and other groups of low-income families—who is benefited by the proposal and who is hurt, and to what extent? Because of the complexity of the Administration's proposal, this is a difficult question to answer definitively. We attempt a rough answer in Section 6 by looking at the effect of the proposal on several types of families. The extent to which individual States will supplement the benefits which are provided by the Federal Government is the main complication in assessing who will gain and who will lose. There are incentives for such supplementation in the proposal, and these are explained in Section 7. Finally, in Section 8, we critique the Administration's proposal. First, the likely advantages of the plan are summarized; then a long series of concerns and potential problems with the proposal are enumerated by means of a list of questions which should be answered before the program is implemented.

2. ADVANTAGES OF THE CURRENT SYSTEM

At present the welfare system as generally thought of consists of three income-tested programs: Aid to families with dependent children (AFDC) with about 11.5 million recipients, supplemental security income (SSI) with roughly 4.5 million recipients, and food stamps with about 18 million recipients. AFDC and SSI provide benefits in cash while food stamps provide benefits in-kind. These programs would be consolidated under the Administration's plan.

In addition, there exist a number of other income-tested programs not directly affected by the Administration's plan: Certain veterans' benefits and pensions, housing assistance programs, basic opportunity grants for higher education. Finally, there is Medicaid, the largest income-tested program of all (currently about 25 million recipients). The Administration's plan, as such, does not mention Medicaid. National health insurance proposals promised for next spring by the Administration, however, will probably be offered as a replacement for Medicaid.

These programs, plus the non-income-tested social insurance programs such as old age survivors, disability and health insurance, and unemployment compensation provide a great deal of relief to the poor. In fiscal year 1977, $49 billion in public funds were spent on income-tested programs, and another $134 billion were spent on social insurance. About two-thirds of the $49 billion of welfare expenditures were financed by the Federal Government. These programs have expanded rapidly since 1965 both in the number of recipients and in the average benefit per recipient. In 1965, $8.9 billion or 1.3 percent of GNP was spent on income-tested programs: this had increased to $39.4 billion or 2.8 percent of GNP by 1974. The programs successfully deliver their benefits to the poor: About 92 percent of AFDC benefits and about 83 percent of food stamp benefits go to those who would be poor in the absence of transfers. Although the current system has been characterized as a "mess," and although President Carter feels that the welfare system is worse than he had expected, it has been successful in targeting increasing amounts of relief to an increasing number of poor beneficiaries.

Several important attributes of the Administration's plan are already present in this set of programs. Food stamps, for example, work in a manner which is similar to the work benefit and income support provisions of the Administration's proposal. As in the proposal, food stamp benefits depend on the amount of earnings and other income of the family and on family size, and accrue to all types of families. The program includes a work test. Similarly, the SSI program, in operation since 1974, has rules of operation and a uniform national minimum payment much like those of the income support provisions of the Administration's proposal. However, the SSI program currently serves only the aged, blind, and disabled, while income support in the Administration's proposal would go to the entire population. Also, the earned income credit, an important component of the Administration's proposal, is already in place.

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3. PROBLEMS ASSOCIATED WITH THE CURRENT SYSTEM

The problems of the current welfare system have been evaluated and cataloged numerous times.[1] As a result, our discussion of them will be very brief and terse. First, the existing welfare system is inequitable. It treats people who have similar needs differently. A one-parent family of four living in Mississippi is entitled to $2,712 per year in AFDC and food stamps, while a similar family living in Hawaii is eligible for $7,044. In addition to the inequity itself, these geographic disparities encourage migration from low-benefit to high-benefit States. Second, welfare treats people differently who have similar needs but are of different family types. In any of the 26 States without an AFDC program for unemployed parents, a family with two parents but no earnings becomes eligible for AFDC benefits only if the father deserts the family. If the father stays with the family, it will be eligible only for food stamps.

Besides discouraging marital stability and encouraging migration, the current system discourages work. In some cases benefits are higher if an individual doesn't work than if he/she takes a job. And in some States a two-parent family of four receiving benefits from the AFDC program for unemployed parents suffers a loss in income if the father goes from a part-time job to a full-time job. In taking the job and leaving the AFDC–U program, Medicaid benefits might also be lost.

Moreover, benefits in these welfare programs are income-conditioned, so that as labor income rises, benefits fall and, as a result, the reward from working is diminished. Because some families participate in two or more of these programs at the same time, the total loss in benefits caused by increased earnings may completely offset the increase in earnings.

Finally, each of the welfare programs has different operating rules. In a single household, one person may receive food stamps and AFDC benefits while another receives food stamps and SSI benefits. Since each program has different rules, different accounting periods, and different notions of the filing unit, administration is complex. AFDC is administered by the States with Federal sharing of payments, while SSI is a Federal program with payments that the States can supplement.

Thus the welfare systems, despite the advantages cited in Section 2, covers some people but not others, pays varying amounts of benefits to persons with similar needs, and is difficult to administer. In addition, it contains adverse work incentives, migration incentives, and incentives for family break-up. Perhaps most seriously, it is too complex for many of the poor to understand. Therefore, they may not receive benefits which they need and to which they are entitled.

[1] See, for example, M. Barth, G. Carcagno, and J. Palmer, "Toward an Effective Income Support System: Problems, Prospects, Choices." (Madison: Institute for Research on Poverty, 1974); and U.S. Congress, Joint Economic Committee, "Studies in Public Welfare," 1974–1976. (Washington, D.C.: Government Printing Office.)

4. AN OVERVIEW OF THE ADMINISTRATION'S PROGRAM

To fully comprehend the Administration's welfare reform proposal, it must be seen as part of a comprehensive set of changes in the income tax, the health care system, social security, the low-wage labor market, and even in the energy market, as well as in the welfare system. All of these programs or systems are somehow affected by the proposal. Even if the legislation passes, the effective date for the changes is not until October 1980, and all the details of the plan are not yet available. But there are already some hints, even as regards the changes in the personal income tax and the medical care system, which are implied by the proposal. The threshold levels at which personal income taxes begin would rise and the earned income tax credit would benefit many more households; Medicaid would be replaced by a national health insurance plan as yet to be designed; aid for the low-income aged, blind, and disabled would be removed to a considerable degree from the social insurance system; public jobs would be provided, but in such a way that a public job would be more lucrative than welfare and a private job more remunerative than a public job paying the same wage; and, finally, the energy tax would pay part of the welfare and jobs bill.

Compared with the current system, large gains have been claimed. (*a*) Welfare would be integrated with earnings and both coupled with the tax system. (*b*) Consolidation would streamline administration. (*c*) Work would always pay more than welfare. (*d*) Family stability would be enhanced by allowing married couples with children to benefit in the same manner and to the same extent as single parent families. (*e*) The relatively high national minimum payment would reduce incentives for migration from high- to low-benefit States. (*f*) States and localities would be provided fiscal relief.

The details of the Administration's program for better jobs and income can best be understood by focussing seriatim on its four major components: Job opportunities, the work benefit and income support provisions for those expected to work, income support payments for those not expected to work, and tax reductions through the earned income tax credit.

Job Opportunities

First, $8.8 billion would be set aside to create up to 1.4 million public service jobs for adult workers with children who cannot find a private job. Most of these jobs would pay the minimum wage, which currently is $2.30 but which is expected to be $2.65 later this year and about $3.30 by about the time the program would begin in 1980. Those eligible for the jobs would be adults—one per family—who would be placed in the "expected to work" category. These people would be given a job only if they were unable to find a regular private or public sector job on their own or with the Labor Department's help.

In determining which families have an adult who is expected to work, there would obviously be administrative discretion. But, basically one member of all families would be expected to work unless all the adults in the family fall into one or another of the following categories: Aged, blind, disabled, or mothers without husbands (and fathers without wives) whose youngest child is less than 7 years old. Mothers without husbands (or fathers without wives) whose youngest child is between 7 and 14 years would be expected to work part time, while such parents whose youngest child is over 14 would be expected to work full time. Because earnings from employment in a private job would be accompanied by a subsidy—the earned income tax credit (EITC)—in addition to the work benefits, a family would always find a private job more lucrative than a public job. This restriction of the EITC to regular private or public sector jobs gives an incentive for workers to use the public service jobs only as a last resort.

Work Benefit and Income Support for Those Expected To Work

Earnings of low-wage workers would also be supplemented by the cash support system. Unlike the benefits from the EITC, however, the cash support system would add to the income of those in the special public jobs as well as all other job holders. The size of the cash supplement would depend upon earnings, other income, and family size, and upon the whether or not the family is expected to have a working member. Cash supplements for a four-person family would start at $2,300 when a family member is expected to work, and remain at that level as long as earnings are less than $3,800. The cash supplement would decline by 50 cents for every dollar of earnings in excess of $3,800, becoming zero at $8,400. In addition, the family with regular earnings would receive benefits from the earned income tax credit (according to a schedule defined below) to supplement both earnings and income support benefits. Cash support benefits would decline by 80 cents for every dollar of unearned income (e.g., social security).[1] Smaller families would get smaller supplements. The maximum supplement for a family of three, for example, would be $1,700; a family of five, in contrast, would have a maximum supplement of $2,900. (The relationship between earnings, family size, and cash supplements is so important that it is discussed in great detail in Section 5.)

Income Support for Those not Expected To Work

For a family of size four in which no one is expected to work, a basic income support payment of $4,200 would be granted. Thus, the maximum support payment for a family not expected to work would exceed by $1,900 that for a family expected to work. For this group, benefits would fall by 50 cents for every additional $1 of earnings right from the first dollar earned—there would be no $3,800 "disregard" range as would be the case for those expected to work. The not expected to work group would include most of the current AFDC recipients and all SSI recipients, and for many of them benefits would increase under the proposed program.

Tax Reduction

The final component of the plan is tax reduction. Since 1975, we have had a tax credit for low earnings families with children—the

[1] Cash supports fall by 90 cents per dollar of unemployment benefits.

earned income tax credit. This credit, for example, gives benefits of $400 (either as cash or as reduced taxes) to a family with $4,000 of earnings; $200 for families with $2,000 or $6,000; no benefits to families with more than $8,000 or no earnings at all. Under the new program, benefits from this credit would be increased for all families with regular earnings (meaning earnings from jobs other than the special public jobs) of more than $4,000 but less than $15,620. Indeed, all families earning between $8,000 and $15,620 would receive a benefit for which they are not now eligible. For those with $8,000 of earnings, the benefit would rise from zero to $600. For a family of four the maximum benefit would be $654 at $9,080 of earnings. More than half of all families would pay lower taxes because of the increased earned income tax credit.[2]

In addition, the level of income at which families would be liable for income taxes would be raised from the 1977 level of $7,200 to $9,080. The President's announcement did not explain how this new tax threshold is established; however, a substitution of a $250 nonrefundable tax credit for the existing $750 personal exemption would accomplish this shift.

The provision of jobs for those expected to work, plus the increase in income support for those not expected to work, plus the work bonus, the earned income tax credit, and the raised tax threshold for those who are expected to work and who do work, would mean a total increase of between $4 and $13 billion (depending on how the score is kept) in the income flowing to the low-income population and to the lower middle and middle income population as well in the first year. These figures bracket estimates of the full cost of the Administration's proposal.

Several other features of the plan deserve brief mention:

While benefit levels and eligibility criteria have been stated in annual terms, in reality, this would be a monthly program. Cash supplements and the EITC would be calculated and paid monthly based primarily upon income in the payment month.[3]

The plan contains an asset as well as an income test for eligibility. Enough assets would cause a family to be ineligible even if its earnings were low. Further for an eligible family, earnings would be attributed to its assets above and beyond any income the family may have received in the form of interest, dividends, rents, and royalties.[4]

Finally, virtually no one in the civilian, noninstitutionalized population would be categorically excluded. Single persons, married couples, individuals living together in group quarters, students, aliens, residents of Puerto Rico and the territories, and other residents would be eligible as long as the living unit meets the income and asset requirements.

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[2] It should be noted that this component of the program is available only to families with children. As a result, it provides an incentive to have additional children by reducing the net cost of them. The transfer component of the program also has this pro-natalist effect by placing single parent families with young children on a higher benefit schedule than such families with older children and by not requiring work from single families with young children.

[3] However, the benefits so calculated would be adjusted downward if the family's income in any of the preceding 6 months was above the level for which the family would have been eligible for income support.

[4] The assets test has a "notch" in it. Families with financial assets of $1.00 over $5,000 lose eligibility for all program benefits.

5. HOW BENEFITS CHANGE WHEN EARNINGS INCREASE

Because all components of the program fit together and because most of them condition the amount of benefits provided on the level of earnings (and other income) of the family, the plan is complex. In this section, the pattern by which benefits would change with earnings will be shown for each component of the plan. Then, in the next section, the way in which all these components fit together will be illustrated by showing how each of a number of representative families would be affected.

The clearest way of illustrating how benefits would change as earnings change is by means of the "45-degree diagram." Such a diagram is shown below as Figure 1. On the horizontal axis, dollars of *earned* income are plotted; dollars of *total* income are plotted on the vertical axis. The line running diagonally through the diagram is drawn at 45°—it divides the area between the two axes into two equal parts. Because of how it is drawn, any point on the 45° line indicates that total income is equal to earned income. This is shown at point A in the diagram. If there were no taxes, no unearned income, and no income supplement benefits, every family would fall on that 45° line. The effect of taxes is to drag the family below that line; benefits boost the family above the line.

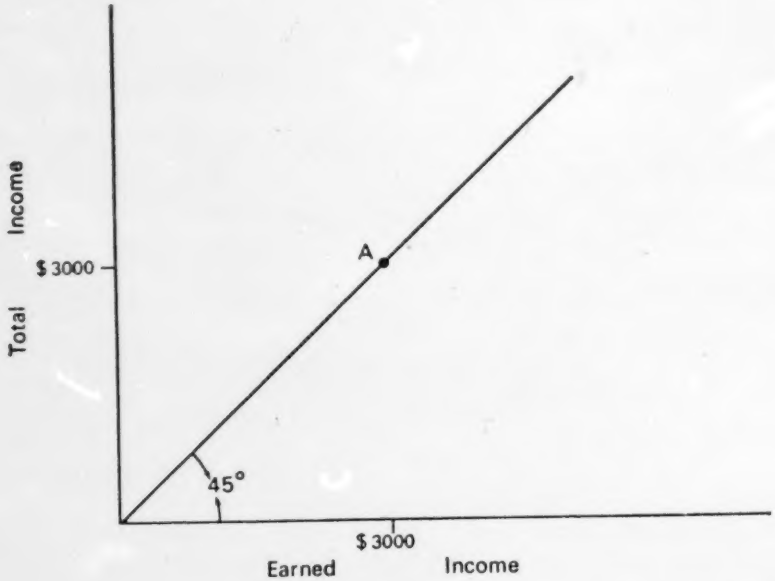

FIGURE 1.—The 45° diagram.

With such a diagram, the way in which benefits under the Administration's plan would vary with earnings can be seen. First, consider the benefits for a family of four in which no one is expected to work. The program would grant each such family $4,200 of benefits (shown by point A in Figure 2). If such a family did have earned income, even though unexpected, the $4,200 of benefits would fall by 50 cents for each $1 of earnings. Because of this feature, a family of four would find itself somewhere along the heavy black line ABCD in the figure, As can be seen, if the family earned $8,400 benefits would fall to zero. The Administration's program, then, would shift the relevant line for families not expected to work up from the 45° line to the heavy black line, which connects to the 45° line at point D. Below $8,400 of earned income, the family would receive income supplements, and this is shown by the dotted and striped area in the figure. As that area shows, more benefits would be given to families with lower earnings than to those with higher earnings.

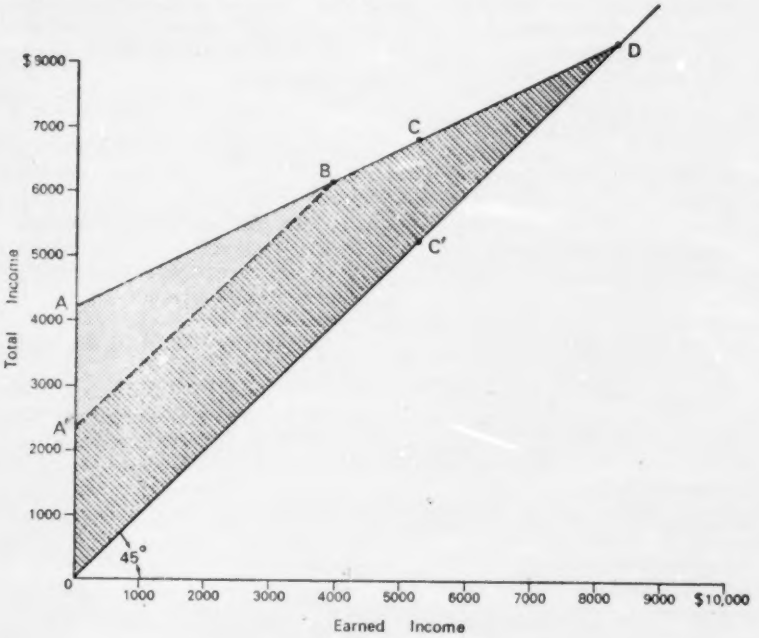

FIGURE 2.—Some components of the Administration's plan.

Quite a different plan would apply to families expected to work. For such families, income supplementation benefits would be lower—with no earnings only $2,300 of benefits would be provided. This is shown by point A′ in Figure 2. This level of benefits—$2,300—would be provided to families expected to work until they have earned $3,800 (point B). Beyond earnings of $3,800, the $2,300 of benefits would be reduced by 50 cents for each additional dollar of earned income. This

two-level structure is illustrated by the kinked dashed then solid benefit line A'BCD in Figure 2, and the area of benefits is striped. Between A' and B the benefit reduction rate would be zero;[1] between B and D it would be 50 percent. The total income of the family at various levels of earnings can be read from the line. Again, income supplements would end when earnings reach $8,400. Between points B and D the two lines coincide—benefits would be the same for those expected to work and for those not expected to work if earnings are the same.

The third source of benefits from the plan would also assist those families expected to work. These benefits would come from the 1.4 million last resort public jobs created by the program. The public jobs, it will be recalled, would provide employment for the principal wage earner in families expected to work, if that person could not find a job in the regular private or public sector labor market.[2] Rather than zero earned income, a family with a person holding one of these jobs would earn an income of $5,300—the minimum wage of $2.65 per hour times full-time work of 2,000 hours per year. Shown on the 45° diagram (Figure 2), such a family would attain point C' with the special job, rather than zero earnings and nonemployment. In addition, by having a worker, the family would be eligible for the income support benefits—which in this case would add $1,550 to the family's $5,300 of earnings, for a total income of $6,850. This is shown as point C.

Figure 2 illustrates the cash benefits—or welfare—aspects of the program. These components provide the major source of income support to families and determine the primary relationship between benefits and earnings. However, this relationship is also influenced by the earned income tax credit (EITC), the social security payroll tax (FICA), and the personal income tax (PIT) (none of which are shown in the figure). Both the EITC and the PIT would change as a consequence of the Administration's welfare and tax proposals, and he has suggested that FICA also be changed to meet the emerging deficit in the social security trust fund.[3]

The Administration's proposal would have the EITC work as follows for a family of four. From zero earnings to $4,000 of earnings there would be no change, with benefits rising from $0 to $400 (i.e., the credit is 10 percent of earnings). Beyond $4,000, the EITC would be higher than at present, reaching a peak of $654 at $9,080 of earnings for a family of four (i.e., to the $400 credit on the first $4,000 of earnings would be added a credit of 5 percent of earnings between $4,000 and $9,080).[4] Thereafter, benefits would decline by 10 cents per dollar of earnings[4]—reaching zero at $15,620. This would be a sizable expansion,

[1] The benefit reduction rate describes the amount by which benefits are reduced as a recipient's income increases. The higher is the benefit reduction rate, the smaller is the increase in family income, and the greater is the disincentive to earn additional income.

[2] The principal wage earner would be the adult who had the highest earnings or worked the most hours in the previous year. If the principal wage earner became disabled or incapacitated, a job or training slot would be made available to another adult in the family. In some families the principal earner will be the wife, in some others a child.

[3] The final resolution of the change in FICA has not yet been determined by the relevant congressional committees.

[4] The point at which benefits begin to decline would vary with family size, and they would begin to decline at that income threshold at which the family would begin to pay personal income taxes in the absence of the credit. Eligibility for the EITC is not changed under the Administration's proposals—households without dependent children would remain categorically excluded.

carrying benefits in the form of tax reductions almost up to the median income level. It should be noted, however, that although this is tabbed an earned income tax credit, one kind of earnings would be excluded from benefits—the earnings from the special public jobs. This exclusion is to make regular private or public employment financially more attractive than the special public jobs.

Changes that would be made in the positive income tax are not explicit in the Administration's welfare proposal. Rather, the changes are implied by the threshold levels at which personal taxes would begin to be paid. As indicated earlier, the specified threshold level of $9,080, which is above the current $7,200 threshold level for a family of four, probably results from substituting a $250 per capita tax credit for the current $750 personal exemption, along with a slight change in tax rates.

An example of how benefits would change with earned income if the entire Administration's package becomes law is illustrated in Figure 3 by the line, ABCDEF. The benefit that would be paid under the Administration's plan at each earnings level, for an intact family of four with the head employed in a regular private or public sector job, is shown as the area between ABCDEF and the 45-degree line. The line A′B′C′D′E′F′ represents current benefits for the same type of family. Total income under the proposed Administration's plan would be determined by the supplemental income supports, the earned income tax credit, the social security payroll tax, and the personal income tax. For the current system, the bonus value of food stamp benefits and the existing tax structure determine total income. (Figure 3 applies to a State where there is no AFDC program for unemployed fathers.)

CURRENT SYSTEM [5]

From point A′ to B′ ($0 to $1,200 earnings) there is no benefit reduction rate for food stamps because of an assumed $100 monthly standard deduction incorporated into the benefit schedule of the program. The cumulative benefit reduction rate is thus −4 percent as the 10 percent credit rate of the EITC is reduced by the employee share of the social security payroll tax (6 percent). From B′ to C′ ($1,200 to $4,000), the 30 percent tax rate of food stamps is added, resulting in a cumulative rate of 26 percent. From C′ to D′ ($4,000 to $7,200) the 10 percent credit rate of the EITC changes to a 10 percent tax rate—the cumulative rate is increased to 46 percent. From D′ to E′ ($7,200 to $8,000) the cumulative rate rises to 60 percent as the family begins paying the personal income tax at the 14 percent first-bracket rate. Beyond E′ ($8,000) the tax rate falls to 20 percent as both food stamps (30 percent) and the EITC (10 percent) have been phased out. The tax rate now depends only on the payroll tax and the income tax. Beyond F′ the rates rise due to the progressive tax rates in the personal income tax.

[5] This discussion and Figure 3, it should be noted, ignores State income taxes, which would increase the combined tax rate over the income ranges to which they apply. It should be borne in mind that "current" refers to fiscal year 1977 while the Administration's program refers to fiscal year 1978.

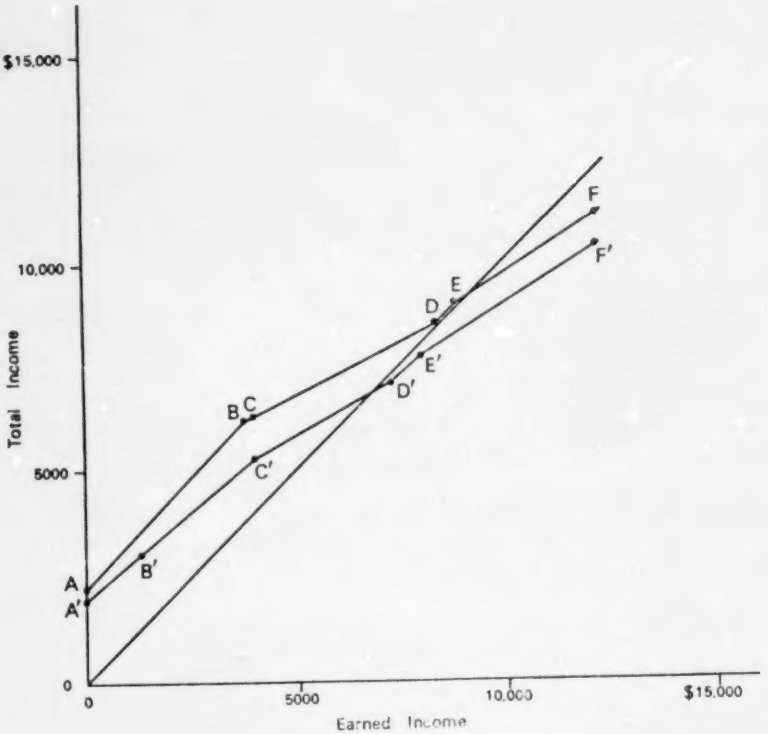

FIGURE 3.—Comparison of Administration's proposal and current system: Intact family of four.

PROPOSED SYSTEM [6]

From A to B ($0 to $3,800 earnings) the tax rate is −4 percent because the income support program "disregards" the first $3,800 of earnings. The rate is due to the 10 percent credit rate of the EITC and the 5.85 percent tax rate of the payroll tax. From B to C ($3,800 to $4,000) the rate increases by the 50 percent benefit reduction rate of the income support provisions, resulting in a cumulative rate of 46 percent. Between C and D ($4,000 to $8,400) the tax rate increases to 51 percent as the EITC credit rate falls from 10 percent to 5 percent. From D to E ($8,400 to $9,080) the tax rate falls to only 1 percent because the income support program and its 50 percent tax rate have been phased out—the cumulative rate of 1 percent is due to the 5 percent credit of the EITC and the 6 percent payroll tax. Beyond E ($9,080) the tax rate rises to 35 percent—the EITC switches from a 5 percent credit to a 10 percent tax, the social security tax is 6 percent,

[6] Assumes that the $750 personal exemption is replaced by a $250 per capita credit.

and the personal income tax begins at 19 percent—and continues to rise due to the progressive tax rates in the personal income tax. Beyond $15,600 the rate drops by 10 percent as the EITC is phased out (not in diagram).

The most obvious characteristic of Figure 3 is that total income at every earnings level would be higher under the proposed system than under the current system (ABCDEF is everywhere above A′B′C′D′E′F′). For example, at zero earnings the Administration's plan proposes to give the family an income guarantee of $2,300, while the existing system guarantees food stamps worth $1,992.[7] Similarly, line A′B′C′D′E′F′ crosses the 45° line at about $7,000 of earnings, while benefits would be positive until about $9,200 under the proposed system. The largest differences between the two systems occur in the range of earnings between $3,000 and $11,000.

From this catalog of interdependent components it is clear that most intact families below $15,000 of annual earnings would be affected by at least three components of the Administration's plan, and that some families might receive benefits or pay taxes as a consequence of all the components. Together, these components form a system designed to provide income support for those at the lower end of the income distribution.

In this example, all families would gain from the Administration's plan. In the next section we examine some more detailed cases that apply to other types of families, some of which might lose under the Administration's plan.

[7] Food stamp benefits are indexed and would be higher than the 1977 value of $1,992 for a family of four by 1978, but probably not so high as $2,300.

6. THE ADMINISTRATION'S PROGRAM AND SOME PROTOTYPICAL FAMILIES

Because of the complexity of this multicomponent system, we will select several kinds of families and indicate how each family type would be affected by the President's proposal. In each case, the way in which the several components of the proposal would contribute to the family's financial position will be described. We will also show how the family's position with the President's program would compare with their current position without it.

Tables 1, 2, and 3 present such a comparison for three family types: (*a*) A couple whose head is aged, but not eligible for social security; (*b*) a female-headed family of four in which the head currently receives AFDC, but is not employed; (*c*) an intact family of four in which the head is not employed. Within each family type, where relevant, we will illustrate the benefits for those families not expected to work, those expected to work part time, and those expected to work full time. For the last two groups we examine two situations—one in which a job is refused and the other in which the head takes a special public job. In the examples that follow, we do not take into account supplemental benefits which States would add to the Federal basic benefit, even though such supplementation is likely to occur.[1] They could not be taken into account here because the supplementation plans the States would actually choose to adopt are not now known. State supplementation options are discussed in a general way in Section 7.

Family Type (1): Head Not Expected To Work; Aged Couple Not Eligible for Social Security; Head Earns $1,000 Per Year in Part-Time Work

As Table 1 shows, this couple currently receives supplemental security income (SSI) benefits and food stamps amounting to $3,440. The $1,000 in earnings do not reduce SSI benefits because SSI disregards the first $85 of monthly earnings (where there is no other income). Thus, total income is $4,381 under the current system. The Administration's plan would replace SSI and food stamps by the income support program. For this aged couple the income guarantee would be $3,750, but because there would be no income disregard each $1 of earnings would reduce benefits by 50 cents. Thus, the net income of $4,291 under the Administration's plan would be about $100 less than that currently received.[2]

[1] This analysis presumes that States will supplement Federal benefits if the program is passed. For an analysis of the program without State supplementation see Barry Friedman and Leonard Hausman, "Work, Welfare, and the Program for Better Jobs and Income" (U.S. Congress, Joint Economic Committee, October 1977).

[2] Such reductions will not occur immediately for current beneficiaries. The Federal Government will provide supplements to insure that current transfer program recipients do not experience reduced benefit levels during the first year of a 3-year transitional period.

TABLE 1.—COMPONENTS OF TOTAL INCOME: AGED COUPLE, NOT ELIGIBLE FOR SOCIAL SECURITY

	Current system	Proposed system
Regular earned income	$1,000	$1,000
Supplementary income bonus [1]	0	3,250
Payroll tax [2]	−59	−59
Federal income tax [3]	0	0
Supplemental security income [4]	3,200	0
Food stamps [5]	240	0
Total income	4,381	4,291

[1] The amount by which States might supplement the supplementary income bonus would be added to this total. The guarantee of $3,750 is reduced by 50 cents for each $1 of earnings.
[2] This represents the employee's share of the payroll tax—5.85 percent.
[3] The Federal income tax liability is computed by assuming that the standard deduction is $3,200, that a $250 nonrefundable per capita credit replaces the $750 personal exemption, and that the current tax rate schedules remain in effect.
[4] As of July 1977, the basic monthly SSI benefit for a couple is $266.70. This figure is higher in states which supplement the basic benefit.
[5] The bonus value of food stamps is computed by assuming a standard deduction of $50 per month for a couple, and $100 per month for a family of 4.

Because this result is primarily due to the different ways in which the current and proposed systems reduce benefits when other income rises, a similar couple with no earnings would receive $3,750 under the Administration's plan, or about $310 more than the current combined SSI and food stamp guarantee levels.

Family Type (2): Female-Headed Family of Four in Which the Head Currently Receives AFDC, but Is Not Employed

The cases shown in Table 2 are all relevant to current AFDC recipients. In Case I it is assumed that the youngest child in the family is less than 7 years of age, so that the head would be classified under the Administration's plan as not expected to work. Currently, the combined value of AFDC and food stamp benefits range from $2,712 in Mississippi to $6,408 in New York. Depending on the extent to which the States choose to supplement the Federal guarantee of $4,200, the proposed plan might leave the family better or worse off than under the existing system.[3] Case II is a family in which the youngest child is between 7 and 14 years of age, and the head would consequently be expected to work part time under the proposed plan. If she refused either to look for a job or to accept a job offer, the family would receive an income guarantee of $2,300 rather than $4,200—because the penalty for refusing to work would be the loss of the income guarantee of the head of the household.[4] Because this $2,300 would be the family's only source of income, the family would be worse off than under the current system even in the States with the lowest AFDC benefits. Indeed, the family would be only slightly better off than the current maximum bonus value of food stamps benefits. However, if this same woman accepted the part-time special public job (rather than refusing

[3] All the calculations in Table 2 ignore a number of components of the full welfare effect of the program on the families involved. These include the actual child care expenses incurred, and work expenses apart from child care. Some families are now eligible for AFDC because of high day care expenses. Fewer families will be eligible for this reason under the Administration's plan, in which the day care deduction is limited to a maximum of $300 per month. For those cases in which the woman is expected to work, they also ignore the loss of leisure and home production.
[4] The $4,200 income guarantee has the following composition: $1,900 for the head of the household, $1,100 for the second member, and $600 for each of the next five family members.

it) the family would receive a net income of $5,370, an increase of $3,070 over the case where she refused the job ($5,370—$2,300=$3,070.[5] As a result, family income would go up on average $3.07 for each hour of work, even though the special public job paid only $2.65 an hour. This boost in the effective wage rate would be due to the increase in the supplementary income guarantee back to $4,200 upon acceptance of the special public job. Indeed, if the head worked in the private sector at a wage of $2.65 per hour, family income would increase an additional $265 to $5,635 because of the earned income tax credit.

TABLE 2.—COMPONENTS OF TOTAL INCOME: FEMALE-HEADED FAMILY OF 4, ELIGIBLE FOR AFDC AND NOT EMPLOYED

	Case I: Not expected to work		Case II: Expected to work part time		Case III: Expected to work full time	
	Current system	Proposed system	Current system	Proposed system	Current system	Proposed system
Regular earned income	0	0	0	0	0	0
Special public job earnings	0	0	0	$2,650	0	$5,300
Supplementary income bonus [1]	0	$4,200	0	2,875	0	1,550
Earned income tax credit [2]	0	0	0	0	0	0
Payroll tax [3]	0	0	0	−155	0	−310
Federal income tax [4]	0	0	0	0	0	0
AFDC [5]	$720–$5,712	0	$720–$5,712	0	$720–$5,712	0
Food stamps [6]	1,992–696	0	1,992–696	0	1,992–696	0
Total income	2,712–6,408	4,200	2,712–6,408	5,370	2,712–6,408	6,540

[1] The amount by which States might supplement the work bonus would be added to this total. If States choose to supplement, they must also supplement the wage of the special public job. The guarantee of $4,200 is reduced by 50 cents for each $1 of earnings for those expected to work less than full time. For those expected to work full time, the guarantee is only $2,300, but the first $3,800 of earnings are not taxed.
[2] The earned income tax credit is available to families with children, but not for special public jobs.
[3] Employee's share of the payroll tax—5.85 percent.
[4] See table 1, footnote 3 for assumptions.
[5] The minimum benefit shown is for Mississippi; the maximum, for New York.
[6] See table 1, footnote 5 for assumptions.

To summarize this case, then, the female family head who is expected to work part time would have an income of—

$2,300 if she refused to accept the special public service job,
$5,370 if she worked halftime in the special public job, and
$5,635 if she worked halftime in a regular private or public sector job at the minimum wage.

These figures are to be compared with the income range of $2,712–$6,408 under the present system.

In Case III, the youngest child is assumed to be at least 14 years of age. In this case, the head would be expected to work full time under the new plan, and the parameters of the cash assistance provisions would be altered. The benefit reduction rate would remain at 50 cents per $1 of earnings, but the guarantee would be only $2,300. However, this guarantee would not be reduced by the first $3,800 of earnings. If the head accepted a full-time special public job the family would receive $6,540, an amount that exceeds levels of support under the current system in all States.[6] If the head refused to work, the family would receive the guarantee of $2,300 and no more. If the head worked

[5] In this analysis, part-time work is assumed to be halftime work—1,000 hours per year.
[6] If the job were a regular private or public sector job; the EITC would provide an additional $465, for a total income of $7,005.

only halftime in the special public job, then the supplementary income bonus would be only $2,300 (rather than the $2,875 shown in Case II) and the family would receive a total income of $4,795.[7]

To summarize the case of the female family head who is expected to work full time, total income would be—

$2,300 if she refused to accept the special public service job,

$4,795 if she worked halftime in the special public service job,

$6,540 if she worked full time in the special public service job, and

$7,005 if she worked full time in a regular public or private sector job paying the minimum wage.

Again, these income levels are to be compared with the income range of $2,712–$6,408 under the present system.

The cases discussed in this section illustrate several principles of the Administration's plan, namely, that: Family income would increase with work effort; a regular job would be more lucrative than a special public job with the same wage rate; and families with heads expected to work but refusing to work would have lower incomes than under the current welfare system.[8]

FAMILY TYPE (3): INTACT FAMILY OF FOUR IN WHICH THE HEAD IS NOT EMPLOYED; SPOUSE WORKS PART TIME AT A REGULAR JOB FOR $2,000 PER YEAR

This family is, by definition, one in which the primary earner would be expected to work under the new plan. It is difficult to tell how such a family is situated under the current system. It is assumed here that the husband has been unemployed for a long time, and has exhausted his unemployment benefits. In this case, the family might be receiving AFDC–U benefits, but only if it resides in one of the 24 States with AFDC–U. Even in these States, access to the program is often very difficult because of stringent administration. In any case, the family is eligible for food stamps. Table 3 shows that family income under the current system is somewhere between $3,871 (in a State with no AFDC–U program) and $7,488 (in a State with a generous AFDC–U program). If the head is designated as the primary earner, with the special public job total income under the Administration's plan would be $7,623—higher than the highest possibility under the current system. For this family, the hourly wage of $2.65 would raise family income on average by only $1.62 per hour under the proposed plan. This result occurs because of several characteristics of the plan—the benefit reduction rate on the supplementary income bonus (after the first $3,800 of earnings), plus the 5.85 percent payroll tax rate, minus the 10 percent EITC paid on the wife's earnings.

[7] This total income figure is composed of the supplementary income support of $2,300 plus the wages earned of $2,650, less the payroll tax of $155.

[8] Note that State supplements have been ignored in this discussion and that current recipients will not have their benefits reduced during the first year of the program even if the rules of the program indicate a reduction in benefits. Also, if a special public job cannot be found for a head expected to work, the guarantee increases from $2,300 back to $4,200—the guarantee for a family in which the head is not expected to work.

TABLE 3.—COMPONENTS OF TOTAL INCOME: INTACT FAMILY OF 4, HEAD IS UNEMPLOYED

	Current system	Proposed system
Regular earned income	$2,000	$2,000
Special public job earnings	0	5,300
Supplementary income bonus [1]	0	550
Earned income tax credit [2]	200	200
Payroll tax [3]	−117	−427
Federal income tax [4]	0	0
AFDC-unemployed parent [5]	0-5,000	0
Food stamps [6]	1,788-288	0
Total income	3,871-7,371	7,623

[1] The amount by which States might supplement the work bonus would be added to this total. If States choose to supplement, they must also supplement the wage of the special public job. The guarantee of $4,200 is reduced by 50 cents for each $1 of earnings for those expected to work less than full time. For those expected to work full time, the guarantee is only $2,300, but the first $3,800 of earnings are not taxed.
[2] The earned income tax credit is available to families with children, but not for special public jobs.
[3] Employee's share of the payroll tax—5.85 percent.
[4] See table 1, footnote 3 for assumptions.
[5] Approximates the actual benefit range for AFDC-U.
[6] See table 1, footnote 5 for assumptions.

Again, the head in this family might choose to refuse the public sector job offered to him. As before, a rather stiff financial penalty would be imposed on the family. The guarantee would be $2,300, and the family's total income would decrease from $7,623 to $4,383. The difference between these two figures ($3,240) is the net income received from full-time public service work—it averages $1.62 per hour worked. As can be seen from Table 3, the income figure of $4,383, if the head refused work, would be only about $500 more than the family's current position in States with no AFDC–U program.

Family Type (4): Other Family Types

The types described above reflect the bulk of the families that would be affected by the Administration's proposal. However, numerous other types of living units exist, and rules applicable to each are implicit in the proposal. Here we will mention a few of these additional family types and how the proposal would affect them:

Non-aged couples.—Under the current system, childless nonaged poor couples are eligible only for food stamps. If the couple has, say, $3,000 of earnings, the value of food stamps is $480, making their total income about $3,305.[9] Under the Administration's proposal, the couple would be guaranteed a supplementary income bonus of $2,200, which guarantee would fall by 50 cents for each $1 of earnings. With $3,000 of earnings, the couple would receive transfer benefits of $700, and a total income of $3,525 after accounting for the payroll tax. This would be an increase of $220 as compared with their current situation. Two things should be noted, however. First, under the present system, the couple faces an implicit marginal tax rate of 30 percent from participation in the food stamp program. Under the Administration's proposal, the rate at which benefits fall as earnings increase would be 50 percent. Second, the couple would not be eligible for participation in the public service employment programs or the earned income tax credit (both reserved for families with children). On balance, the

[9] This assumes a monthly deduction of $50 for the food stamp computation, and the employee's share of the payroll tax.

effect of the proposal on work incentives and work availability for couples would appear to be slightly negative.

Single individuals.—Single individuals are eligible for only a $600 bonus from the food stamp program in the current system. The Administration's proposal would provide single individuals an income guarantee of $1,100, nearly twice the food stamp bonus. This would appear to be a major income boost, but single individuals are expected to work. If they earn $2,200 or more they will be made ineligible for benefits. For some individuals however (especially those not eligible for unemployment insurance) such as those just leaving school, or those completing prison terms, the program could provide substantial assistance. This assistance can, thus, be viewed as a form of "transition aid." It should be noted, however, that the proposal would raise the rate at which benefits are reduced from 30 percent in the current food stamp program to 50 percent in the proposal. And, like couples, single individuals would not be eligible for a special public job or the EITC.

Self-employed.—A small but interesting set of cases is that of the family head who either is self-employed, or who wishes to become self-employed. One of the major obstacles to starting a new business is the period of very low-income expectations early in the life of the business. Currently, such an individual is eligible for no interim assistance at all (except perhaps a business loan from the Small Business Administration). Under the Administration's proposal, the individual would be guaranteed an annual income of $2,300 (assuming a family of four), and income supplements until income reaches $8,400. If net worth exceeds $20,000, however, the new entrepreneur would be excluded from the program via the assets test.

Very large families.—Under the current system, benefits to large families eligible for assistance generally expand with the size of the family, without limit. The Administration's proposal, however, would place a cap on the guaranteed benefit of $6,000,[10] implying no additional guarantee beyond a family size of seven members. As a result, very large families would be relative, if not absolute, losers under the Administration's plan.

Special circumstance families.—In addition to the family types already listed, there are numerous other family circumstances which would receive different treatment under the proposed Administration's system from the treatment they receive now. These include:

Two nuclear families living together,
A group of single individuals living together,
Units with highly variable income throughout the year, and
Units with very high child care and work expenses.

With the exception of single individuals living together, the remaining types of units would, in general, appear to lose benefits under the Administration's proposal, relative to the current system. This is especially true for the single parents in the AFDC program with substantial work expenses. As is increasingly documented, such expenses are treated very liberally in some State AFDC programs.[11] Potential

[10] This figure is arrived at by cumulating the guarantee for the family head ($1,900), the second member ($1,100), and each additional child up to $3,000 (5 times $600 for each child).

[11] This issue is treated at length in Friedman and Hausman, op. cit.

high work expense recipients in these States would fare better under the existing system. This generalization would appear to hold even though the proposal is not clear on many of the details regarding how such units would be treated, and even though their treatment under the current system varies widely by State and local jurisdiction.[12]

What this review of cases has shown, then, is that several of the claims made for the proposed income transfer-jobs program are, in fact, borne out. First, in none of the cases would earned income be less with the program than it is under the current system—in most of them the work effort of those affected would probably be increased. This increase in work and in earned income is attributable to the combination of the jobs program and the work requirement, and not to a major improvement in work incentives (marginal tax rates) in the income support component of the program. Second, with the exception of the family which failed to accept work and the aged couple which did work, most families would appear to gain financially relative to the national average of such families now. As indicated, some families in the very high AFDC States might be made worse off, but even this would not occur with a reasonable amount of State supplementation of Federal benefits in the existing high benefit States.[13] (This is discussed in the following section.) Third, benefits from the program would, indeed, be carried well up into the middle-income brackets. Only when earnings approached $16,000 per year would families fail to receive any benefits under the plan.[14]

This comparison emphasizes the effect of the proposal on the financial position of the families—it implies little regarding the impact on their real economic welfare. The additional work effort that would be induced and provided by the program would generate more money income, but for single parent families, it would also require the sacrifice of child care and home production provided by the family head, and the loss of whatever value he or she places on leisure. How the gain in money income that would occur compares with the loss of these other things is what determines the effect of the program on the economic welfare of the families. Offsetting these welfare losses is the fact than many low income families do wish to work and are constrained from doing so by the lack of jobs requiring their level of skill. Making jobs available to these individuals would reflect a clear welfare improvement over the existing system. These trade offs are difficult to measure, and as a result we have little to say about them.

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[12] It may be that the work expense deduction tends to rise with income. In that event, the effect of the deduction is to lower the benefit reduction rate in AFDC. Hutchens believes this reduction to be substantial in some States. If he is right, benefit reduction rates will rise in some States if the Administration's plan is enacted, with an associated decline in work effort. See, R. M. Hutchens, "Changes in AFDC Tax Rates, 1967–1971." (Madison: Institute for Research on Poverty, Discussion Papers, 1976.)

[13] As we have noted, if the "grandfathering" provision in the proposal is maintained, no current beneficiary would be adversely affected by the plan for the first year.

[14] Recall that in none of the cases in tables 1, 2, or 3 of this section would the family be required to pay Federal income taxes under the Administration's plan. Also, Figure 3, above, shows that a family of four with an income of about $11,450 would pay only social security taxes. Beyond $11,450, income tax liabilities would be incurred. (These results assume that the tax reform implicit in these calculations actually comes about.)

7. THE SUPPLEMENTATION BY STATES OF FEDERAL BENEFITS

The Administration's proposal would establish a national minimum below which cash assistance benefits would not be permitted to fall. This minimum would be above the sum of the current AFDC and food stamp guarantees in 12 States. Clearly, average cash assistance benefits would be raised in these States. The benefit levels in the remaining 38 States and the District of Columbia are now above the proposed national minimum, but these States would not be required to abandon their more generous benefit levels. Indeed, in general, they would be given financial incentives to at least maintain their current benefit levels. In addition the Administration's proposal would establish a set of procedures not yet specified—involving both sanctions and bribes—designed to induce States not to alter the basic work and family structure incentives in the proposal. The States may be required to accept Federal administration of their supplemental benefits.

In the language of HEW, the proposal would provide Federal sharing in the cost of State supplements to bribe the States to adopt plans "congruent" with the Federal program. Specifically, to be eligible for Federal cost sharing of supplemental benefits under the proposed plan:

(1) The filing unit, asset tests, definition of countable income, and so on must be the same.

(2) The benefit reduction rates must be similar (i.e., approximately 50 percent on earnings, 80 percent on all other income, except for those not expected to work for whom the benefit reduction rate on earnings is to be no higher than 70 percent).[1]

(3) The differences in guarantee levels between those expected to work and those not expected to work and the pattern of income disregards must be similar in the State and Federal programs.

(4) The relationship in the Federal program between cash benefits for various family types and between those who have and those who do not have a public service job must be maintained in the State program.[2]

The hoped-for pattern of State supplementation would have at least four effects. First, it would substantially increase the cash benefits of the Administration's proposal relative to those of the current system. Thus, the effects of the proposal shown in Tables 1–3 are to be interpreted as minimum bound estimates of the effect of the Administration's proposal on the total income of poor families. Second, the addition of State supplemental benefits to the Federal benefit would eliminate much of the horizontal equity among people living in various

[1] In particular, a large jump in the benefit reduction rate must be avoided because higher benefits make recipients subject to the personal income tax, which results in an unacceptably high marginal tax rate.

[2] Because of this provision, the wage rate paid in the public service employment program would have to be supplemented by States if the supplementary income benefits are supplemented.

regions which the new Federal programs alone would produce. As a result, benefits to otherwise similar households would vary by the State in which they happen to reside, and again migration to raise benefits would be possible. Third, in States supplementing the wage rate on public service jobs, the minimum wage rate standard of the Federal program would be abandoned, and the costs per job created would rise from the $7,000 per job figure suggested in the proposal. As a result, fewer than the 1.4 million jobs could be created with the $8.8 billion set aside by the Administration for this purpose. Fourth, the choice of supplementation scheme might raise the benefit reduction rate faced by many families.

8. A CRITIQUE OF THE ADMINISTRATION'S PROPOSAL

As indicated in Sections 2 and 3, the current system of providing benefits to low-income families has both advantages and disadvantages. In this section, the Administration's proposal is subjected to a similar evaluation and critique. First, the advantages and likely accomplishments of the proposal will be described. Then, some probable shortcomings and problems associated with the proposal will be mentioned. Because of the extensive discussion of the proposal in previous sections, the points of advantage and disadvantage will only be mentioned briefly here.

Some Advantages and Likely Accomplishments of the Administration's Proposal

The announcement of the Administration's proposal was accompanied by a long list of its advantages relative to the current system. As we have mentioned previously, many of these advantages appear to be borne out by the analysis of the proposal. These include the following:

The proposal would increase the spendable income of low-income families relative to the current system, primarily through increased earnings.

If States respond as planned to incentives for supplementing Federal benefits, and if the "grandfather" provision of the plan is maintained, only a small minority of current recipients would be adversely affected by the plan.

The plan would, for the first time, extend cash income support to "working poor" families—those intact families whose head is working but not earning enough to raise the family above the poverty line. The serious incentives in the current system for such families to break apart would, thus, be significantly reduced.[1]

The measures to increase work in the Administration's proposal are, in general, stronger than those inherent in the current system. This is primarily so because jobs will be created and secondarily because fathers will not have to be unemployed or disabled to receive cash benefits. Benefit reduction rates will also be lower than in the current system more often than they will be higher.

By establishing a national minimum benefit level, the current inequity among jurisdictions would be narrowed. For the same reason, incentives to migrate to take advantage of higher benefits would be reduced even after State supplementation.

The plan would increase the disposable income of families well up into the lower middle income range by granting tax relief via the earned income tax credit.

[1] This issue is explored in Katharine Bradbury, "The Price Incentives of Income Maintenance Alternatives for Family Composition." (Madison: Institute for Research on Poverty Discussion Papers, 1977.)

Some Problems and Concerns With Respect to the Administration's Proposal

While these likely accomplishments of the Administration's proposal are important ones, the plan is not without problems. Some of these problems have been recognized by the Administration and suggestions to correct or minimize them have been made. Mentioning them here reveals our concern that the proposed remedies have weaknesses of their regions which the new Federal program alone would produce. As a checklist for anyone seeking to either evaluate the proposal or devise revisions in it. And, because many of our concerns relate to matters for which the details of the program have not yet been spelled out, we will simply raise questions which should be resolved before the program is passed and implemented.

Program cost.—The cost of the program—stated by the Administration to be $2.8 billion more than the cost of the current system—is probably understated. Several factors suggest that this is so, including: (1) Unemployment is likely to be above the 5.6 percent assumed by the Administration. For that reason, while 1.4 million jobs would be shifted from emergency employment under thhe Comprehensive Employment and Training Act (CETA) to public service employment for low income workers, emergency employment under CETA is likely to be continued. Moreover CETA is planned to be discontinued if improvements in the employment situation do occur, in which case the cost savings could be used for any alternative program and not only welfare reform. (2) It is inappropriate to count reductions in fraud in the existing welfare system (which is to be abolished) as part of the funds available to finance the program. (3) The nonparticipant wage costs associated with each public service job created (costs for administration, supervision, facilities, material inputs, and transportation) is not to exceed $1,600 per full-time job.[2] That seems low. (4) The saving resulting from more restrictive child care expense deductions—which reduce income when determining eligibility and calculating benefits—may have been overestimated. (5) Attributing some of the revenues of proposed energy legislation to the proposal, when these revenues would be available to be used in any way whether or not the program is passed, is inappropriate. And (6) the full reduction in tax revenue due to the extension of the earned income tax credit by the proposal is not charged to welfare reform.

Work disincentives and notches.—While the cumulative marginal benefit reduction rate in the proposed plan is frequently less than in current practice—thus, increasing work incentives—it may still be substantial (up to 80–90 percent after State supplementation) for some recipients. Moreover, there are undesirable notch problems with some existing programs, notably Medicaid (see below) and in the asset test.

Integration with national health insurance and tax reform.—The Administration has promised both a national health insurance and

[2] The Administration's response to this problem is to note that the total amount to be spent on public service jobs is capped at $8.8 billion, so if these costs exceed $1,600, fewer jobs will be created. This solution fails to address the problem of (and costs associated with) a possibly inadequate supply of jobs due to such a cutback.

a tax reform proposal, both of which are likely to impinge on the structure of the welfare reform proposal. The way in which these forthcoming plans—in particular, the national health insurance proposal—would be integrated with the welfare reform proposal should be carefully scrutinized. Both of these forthcoming proposals, if passed, are likely to have undesirable effects on the cumulative benefit reduction rate. National health insurance would surely be income conditioned, thereby raising the marginal benefit reduction rate. One can also imagine that eligibility for national health insurance will be automatic for certain beneficiaries of cash assistance thereby restoring the infamous "Medicaid notch."[3] The tax reform proposals when they appear may have lower tax thresholds than expected by the welfare reformers. Some would then be paying income taxes while receiving benefits, raising marginal benefit reduction rates. Moreover, there is no obvious way of integrating Medicaid and the welfare system if national health insurance is not enacted. Even though AFDC would be abolished its criteria for Medicaid eligibility may be maintained. Thus two sets of administrative determinations may be required.

Public service jobs.—The mass creation of public service jobs for low wage-low skill workers is something with which this country has no previous experience. The effort is analogous to a private firm's promise to introduce a new product, the manufacture of which requires a technology which has not yet been developed. In all such cases, the effort is fraught with uncertainty, and the possibility of an ineffective and unproductive program must not be neglected. Perhaps the most that can be done is to raise a number of questions which point to potential problem areas. While these questions vary substantially in their importance, all of them should be attended to before full-scale initiation of the program. Some of these questions are: (1) Regarding the prime job sponsors, how would their competence and honesty be judged; where will they be located; would their diversity introduce undesirable inequities among regions or jurisdictions; how would the limited number of jobs be allocated among them and would that allocation create inequalities and discrimination against the least skilled and least productive workers? (2) Can jobs be created which participants will not find demeaning and dead end; will they have a training component facilitating transition to regular employment; can the training be paid for out of the $1,600 allowed for implementing each job; what precautions would be taken to avoid competition with existing private and regular employment, competition which can lead to labor union objections and to displacement with little net job creations; would the wage wedge between special public jobs and regular jobs created by the earned income tax credit be great enough to restrict demand for public service jobs and to induce transition to regular jobs for those employed in special jobs; what would the fringe benefits of public service jobs be? (3) How would the transition from special public sector jobs to private sector jobs be facilitated; what procedures would the prime contractors follow to locate private sector

[3] This "notch" exists because full Medicaid benefits can be sacrificed by a recipient family if earnings increase by a single dollar which would place the family above its categorical eligibility limit.

jobs; would employers be required to list all job openings with the local Bureau of Employment Security Office; if the available supply of public service jobs should prove greater than the demand would there be incentives for contractors to terminate existing holders of public service jobs or to encourage their transition to regular employment? (4) What assumptions underlie the Administration's estimate that 2.5 million individuals would hold the 1.4 million public service jobs over the course of a year; what problems would such turnover create for the administration and, especially, the productivity of the public jobs program?

Labor market effects.—What are the potential labor market impacts of the public service jobs program? In particular: (1) Would the minimum wage (or supplemented minimum wage) jobs be likely to attract some persons now employed in regular public or private sector jobs? If so, in which labor markets, occupations, or production sectors are they now likely to be employed? (2) What would be likely to happen to employment opportunities and wage rates for low skill- low wage workers not eligible for public service jobs (e.g., youths, wives) in such markets? (3) Would employers (of, say, household labor) be likely to encounter increased difficulties in locating workers if the public service employment demand is added to existing demand for low wage labor? (4) Would some functions now performed by regular public employees be assumed by the public service job program, resulting in a reduced growth in regular public employment and in the wages paid public employees? (5) In the aggregate, how much reduction in regular public and private employment growth would occur because of the program, i.e., what would be the extent of displacement of regular employment?

The "phase-in" period.—Introduction of the cash benefits program would have to be complex due to its being phased in over time, with encouragement for State supplementation and with "grandfathering" of existing beneficiaries to assure that they will not experience reduced benefits. Have the inevitable problems associated with this procedure been adequately considered?

Administrative problems in the cash assistance program.—The cash assistance program has several administrative characteristics which, if implemented, could lead to abuse, confusion, and inequities. These include: (1) The potential administrative workload from the stipulation requiring monthly recertification. (2) The potential workload and confusion from the 6-month accounting period. (3) The potential for increased administrative discretion in defining the filing unit, defining which units are and which are not expected to work, defining disability, and determining and enforcing reclassification due to changes in the age of children or the entry and departure of adults from the family unit. (4) The required appellate and judicial process for considering appeals from decisions by program personnel. (5) While three programs (AFDC, SSI, and food stamps) would be replaced by one, the new program would have three distinct parts (the jobs program, the cash assistance program for those expected to work, and the cash assistance program for those not expected to work). Would the gain in administrative efficiency claimed by the Administration and noted above be a gain of sizeable proportions—from either

the Government's perspective or that of the recipient? (6) Could a simpler and perhaps equally effective reform be accomplished by simply cashing-out food stamps (after, say, raising the guarantee to $2,300 for a family of four), mandating AFDC–U, and increasing funding for existing public service jobs and training programs or perhaps still other reform alternatives? (7) Would the centralized computer system actually be able to carry the load and insure that administrative practices in the cash transfer programs would not differ among States or regions?

Indexing and regionalizing benefits.—The new plan does not include indexing to insure that the real value of benefits and wage rates would not decline with inflation. Similarly, no significant regional differential in benefits or wage rates is built in to reflect cost of living differences. Are the advantages of these two omissions likely to exceed the costs of including them in the plan?

The earned income tax credit.—As noted above, the earned income tax credit would be extended to rather high earnings units. Are problems of integrating this provision with the positive income tax created thereby? Would the monthly withholding designed to reflect this credit create administrative difficulties for small business, especially those whose employees are low-wage workers in eligible households? Would there be an annual reconciliation to balance out credits paid in some months with net taxes owed in other months for those with unstable income flows over the course of a year?

9. CONCLUSION

Our review of the current welfare system and of the Administration's proposals provides convincing evidence of the complexity of the "welfare mess." Many economic hardships can befall a family—unemployment, absence of one parent, disability, low earnings—and each hardship requires a different policy response if a balance is to be struck between the goals of providing adequate incomes, maintaining work opportunities and incentives, and insuring family stability. The multiplicity of both program goals and economic situations interact to produce the juxtaposition of the advantages and problems of the Administration's plan described in the previous section. A quick review of the former leads to the optimistic conclusion that the "welfare mess" has been untangled and that many low- and moderate-income Americans will be helped; a quick review of the latter, to the pessimistic view that numerous problems still remain, and that some of them may be insoluble.

In general, the Administration's proposal is a movement in the right direction. In our view, the reduction of benefit inequities between one- and two-parent families and among regions, the increased incentives and opportunities to work, the decreased incentives for family breakup, and the use of earnings supplements to favor regular public and private sector jobs relative to special public service jobs are aspects of the Administration's proposal which contribute to important equity and efficiency objectives. However, it is a proposal needing refinement—a first step rather than a final solution. Problems of administration and integration with other income conditioned programs are severe, as are the problems of creating and filling over 1 million meaningful and productive public service jobs. Moreover, the additional costs of securing better jobs and income may run to several times the amount suggested by the Administration. Welfare reform, like tax reform which it closely resembles, may have to be a recurring event.

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